BEFORE THE DEPARTMENT OF JUSTICE
OF THE STATE OF MONTANA

In the matter of the amendment of ARM 23.16.101, 23.16.122, 23.16.202, 23.16.1703, 23.16.1705, 23.16.1823, and 23.16.2602 and the repeal of ARM 23.16.1803, 23.16.1805, and 23.16.1807 pertaining to loans to licensees from institutional and noninstitutional sources, use of checks and debit cards for certain gambling activities, prohibition on use of credit cards for gambling, sports pool wagers, and applications, fees and issuance of video gambling machine permits	)	NOTICE OF AMENDMENT AND REPEAL

TO: All Concerned Persons

1. On August 18, 2017, the Department of Justice published MAR Notice No. 23-16-247 pertaining to the public hearing on the proposed amendment and repeal of the above-stated rules at page 1352 of the 2017 Montana Administrative Register, Issue Number 16.

2. The department has amended ARM 23.16.202, 23.16.1703, 23.16.1705, 23.16.1823, and 23.16.2602 as proposed, and repealed ARM 23.16.1803, 23.16.1805, and 23.16.1807 as proposed.

3. The department has amended the following rules as proposed, but with the following changes from the original proposal, new matter underlined, deleted matter interlined:

23.16.101 DEFINITIONS (1) through (15)(b) remain as proposed.

(i) who make actual debt payments on behalf of a gambling licensee and ~~who~~ fail to meet the suitability requirements of 23-5-176, MCA; or

(ii) who make actual debt payments on behalf of a gambling licensee and ~~who~~ fail to timely make complete disclosures of payments as required by 23-5-118, MCA;

(c) through (21) remain as proposed.

23.16.122 LOAN EVALUATION - GUARANTOR PAYMENTS (1) through (2)(a) remain as proposed.

(b) a loan guarantor on a noninstitutional loan must within 90 days of ~~the~~ any payment under the guarantee elect to treat payments made under a ~~loan~~ guarantee agreement as loans, paid in capital, or other equity contributions.

(i) through (7) remain as proposed.

4. The department has thoroughly considered the comments and testimony received. A summary of the comments received and the department's responses are as follows:

COMMENT #1: This rules package was a direct result of legislation passed in the 2017 legislature. Commenters at the public hearing thanked the gambling control division for its role in working with gambling industry representatives and representatives of nonprofit organizations during the session on SB 25 (relaxing gambling machine permit restrictions in certain cases, allowing nonprofits to sell raffle tickets online, and creating gift enterprise exclusions), SB 302 (allowing use of checks and debit cards for Calcutta auctions and casino nights), and SB 344 (removing impediments on loans from regulated lenders). Except for comments pertaining to certain rules implementing SB 344 (set out below), all public comments were favorable.

RESPONSE #1: The department will adopt each of the proposed rule amendments and repeal those rules for which it received favorable comments or no comments at all.

COMMENT #2: Two commenters opposed the proposed changes to ARM 23.16.101(15), amending the definition of "owner" or "owner of an interest" in a gambling license.

One comment noted that the proposed language of the amendment provided that a coborrower, guarantor, or pledgor of collateral on a loan to a gambling licensee from a regulated lender could be found to be an owner of an interest in a gambling license if that person failed to meet the suitability standards found in 23-5-176, MCA, or failed to timely disclose payment on behalf of the licensee. In that commenter's judgment, the rule leads to an absurd result because it declares that one unsuitable to hold a license is, by definition, an owner of the licensee whose loan he or she is supporting as a coborrower, guarantor, or pledgor.

The second commenter concurred, suggesting the language of ARM 23.16.101(15)(b) should be parallel to that found in ARM 23.16.101(15)(a). This change, the commenter suggested, will clarify an ownership interest does not arise unless a payment is actually made by a coborrower, guarantor, or pledgor.

RESPONSE #2: The department recognizes the apparent unintended result of an unsuitable person being declared an owner of an interest in a licensee. However, the amendments to 23-5-118, MCA, found in SB 344 specifically declare that, in a regular commercial loan to a licensee, a coborrower, guarantor, or pledgor will not be an owner of an interest in the licensee *only if* the coborrower, guarantor, or pledgor meets the suitability standards of 23-5-176, MCA, and the licensee timely discloses the payment. *See* 23-5-118(4) through 23-5-118(6), MCA. The implication, as noted by a commenter, is that the coborrower, guarantor, or pledgor

could be an owner of an interest if the person is unsuitable or the payment is not disclosed.

While that appears to be a possibility, in practice that outcome is unlikely because the department has designed other rules calling for a suitability determination before the coborrower, guarantor, or pledgor makes a payment. Under the proposed amendments to ARM 23.16.122(3) and (4), an applicant or a licensee with a loan supported by a coborrower, guarantor, or pledgor must disclose that loan to the department to initiate a suitability investigation. In both cases, the coborrower, guarantor, or pledgor may not make a payment on the loan until after the investigation demonstrates suitability.

No coborrower, guarantor, or pledgor may make a payment on the licensee's loan until the department has determined the payor meets the requirements of 23-5-176, MCA. ARM 23.16.122(3) and (4) as adopted in this notice.

The department's proposed rules are designed to avoid the peculiar result of an unsuitable person being statutorily declared to be an owner of an interest in a gambling license. Statutes must be interpreted and rules devised to fulfill the state's public policy of a clean gambling industry, permitting only suitable individuals to participate. *See* 23-5-110 through 23-5-176, MCA. Well-established rules of statutory construction require statutes to be applied in concert to effect the Legislature's intent. *See, e.g., Houston Lakeshore Tract Owners Against Annexation Inc. v. City of Whitefish,* 2017 MT 62, ¶10 (courts interpret statutes as part of a whole statutory scheme to avoid an absurd result). The proposed rules aim for the same result. Consequently, under other proposed rule amendments, a coborrower, guarantor, or pledgor will not be allowed to make a payment unless they are first found to be suitable under the standards of 23-5-176, MCA.

Nonetheless, commenters found the language of the proposed rules difficult to understand which suggests the need for improvement. To underscore the fact that, in a regulated loan, a coborrower, guarantor, or pledgor could only be found to be an owner of an interest in a licensee if they have made a payment, the department will include such language in the amendments to ARM 23.16.101(15)(b).

COMMENT #3: Commenters objected to the proposed amendments found in ARM 23.16.122(6) and (7), related to nonlicensee loans, arguing the rule could improperly and unnecessarily extend into licensee's personal loan transactions unrelated to the gambling operation.

The proposed rule requires disclosure of a licensee's participation as a coborrower, guarantor, or pledgor in a nonlicensee's loan. Commenters objected on the grounds that such a rule would require a licensee to disclose co-signing on an automobile loan for a child or a child's student loan. Commenters viewed the rule as overreaching into a licensee's private affairs and involving the department in personal loans unrelated to legitimate regulatory concerns.

RESPONSE #3: The legislature's amendments to 23-5-118, MCA, contained in SB 344 are not limited to commercial loans *to licensees* – the legislation includes commercial loans *to nonlicensees* where the licensee serves as a coborrower, guarantor, or pledgor, supporting a loan to a stranger to the license. That creates the possibility that an unsuitable person, unable to secure a gambling license in his own right, could enjoy the benefits of a license by drawing off a gambling licensee's income in the form of loan payments. The amendments to ARM 23.16.122 creating new (6) and (7) were meant to address that situation by implementing the statute requiring disclosure of the loan and a determination of the suitability of the borrower.

The department concedes that the new rules will have a different impact on sole proprietors than licensees operating under an LLC or corporation. The rules require "licensees" to disclose their participation in loans to third parties and to disclose payments under their obligations as a coborrower, guarantor, or pledgor. In the case of a sole proprietorship, there is no distinction between an individual in his/her capacity as a licensee and in his/her personal capacity. If a parent, who owns a gambling operation as a sole-proprietor, co-signs on a child's auto loan, the rules require disclosure. Conversely, if the parent is a sole-shareholder of a corporation licensed to offer gambling, co-signing on a child's auto loan in an individual capacity need not be disclosed.

One suggestion offered to limit the scope of the rule and to avoid unnecessary disclosure was to change the language from

> A ***licensee*** participating as a coborrower, guarantor, or pledgor, in a nonlicensee's loan from a regulated lender . . . .

to

> A ***licensed entity*** participating as a coborrower, guarantor, or pledgor, in a nonlicensee's loan from a regulated lender . . . .

The aim of the change was to refocus on a business' participation as a coborrower, guarantor, or pledgor rather than a human being's participation as a coborrower, guarantor, or pledgor.

The nature of a sole proprietor is generally understood, but there is no definition of a "sole proprietor" in the Montana code. *Loos v. Waldo*, 257 Mont. 266, 270, 849 P.2d 166, 168 (1993). Simply put, in a sole proprietorship there is no distinction between the business and the individual. The gambling code includes a definition of "person" which "means both natural and artificial persons" and both may be licensees. *See* 23-5-112(32), MCA. Consequently, sole proprietors would see no advantage to changing the language in ARM 23.16.122(6) and (7) from "licensee" to "licensed entity."

In practice, the number of licensees conducting business as sole proprietors is declining in no small part because of the advantages of creating an entity to hold the gambling license separate from the individual himself or herself. Nevertheless, there remain many Montana gambling licensees conducting business as sole proprietorships. The department's duty to assure that strangers to the license are not exerting influence on licensees requires review of these loans. Therefore, while the division is mindful of the impact on certain gambling operators, it must uniformly apply the statutory language and will adopt the proposed rule as written over the commenters' objections.

COMMENT #4: One commenter objected to deleting certain language from the former version of ARM 23.16.122 and urged that the proposed amendments return that language. Formerly, the rule specifically provided that an institutional lender was empowered to limit movement of a licensee's assets. Noting that such restrictions are common in commercial loan documents, the commenter requested that language remain in the amended version of the rule to comport with the intent of 16-4-801, MCA, "to be clear regulated lenders can use their normal loan documents."

RESPONSE #4: The department's rules are meant to implement SB 344's amendments to 23-6-118, MCA. Those amendments declare in plain terms that a regulated lender may use loan documentation consistent with commercial loans generally. The statute is complete enough in itself. Moreover, it would be impracticable to attempt to write a rule that affirms every term typically found in a commercial loan – whether restrictions on movement of assets or a myriad of other loan terms. Therefore, the department will adopt the proposed rule as written over the commenter's objections.

COMMENT #5: One commenter offered the following input regarding the proposed changes to ARM 23.16.122(2) regarding guarantors on noninstitutional loans:

> In (2)(a), pertaining to non-institutional loans, the wording provides that guarantors must meet 23-5-176 requirements prior to closing on the loan. I ask that the Department clarify that if the guarantor is an owner of the licensee entity, they are thus already qualified under 23-5-176, and if the requirements of 23.16.120(7) are met, prior approval is not required for closing on the loan. In other words, please clarify that this provision doesn't limit the applicability of 23.16.120(7).

RESPONSE #5: This commenter envisions an instance in which, for example, a licensee corporation acquires a loan from a third party noninstitutional lender (NIL) source where that NIL source insists upon a guarantee from an owner (a shareholder) of the licensee. The commenter is correct in noting that the shareholder previously would have been investigated and declared suitable under 23-5-176, MCA. In that case, the proposed amendments to ARM 23.16.122(2)(a) will pose no impediment to the NIL with a secured guarantee. But the commenter

argues prior approval should not be necessary in situations covered by ARM 23.16.120(7).

That rule provides prior department approval is not required when an owner of an entity, such as a shareholder, supplies a loan to the entity, such as a corporation (subject to certain restrictions). The loans covered by ARM 23.16.120(7) will involve two parties: a licensee borrower and a shareholder lender. However, the loans covered by ARM 23.16.122(2) will involve three parties: a third party NIL source, a licensee borrower, and a shareholder guarantor.

Typically under ARM 23.16.120(7), there will not be a guarantor because a shareholder is lending money to his own corporation. There is no third party seeking assurances and security from another source. To that extent it is difficult to imagine interplay between the proposed amendments to ARM 23.16.122(2)(a) and ARM 23.16.120(7) and the changes to ARM 23.16.122(2)(a) will not limit ARM 23.16.120(7). Therefore, the division will adopt the proposed rule as written over the commenter's objections.

COMMENT #6: One commenter suggested ARM 23.16.122(2)(b) could be clarified. The proposed version makes reference to an election within 90 days of "the payment." The commenter offered that provision would be clearer if it read, "a loan guarantor on a noninstitutional loan must within 90 days of any payment made under the guarantee elect to treat payments made under …."

RESPONSE #6: The suggestion is accepted and the rule as adopted will be changed accordingly.

COMMENT #7: One commenter suggested that it is unnecessary to require in ARM 23.16.122(3) a suitability investigation on a coborrower, guarantor, or pledgor, if that person had undergone a suitability investigation within two years.

RESPONSE #7: The department understands and appreciates the comment. However, the department's practice of only repeating an investigation after the passage of two years is not established in rule and the department will not insert that term here. Therefore, the department will adopt the proposed rule as written over the commenter's objections.

COMMENT #8: One commenter objected to the requirement of a suitability investigation of guarantors, etc., found in the proposed amendments to ARM 23.16.122(3) and (4), unless the funds from the loan are actually used in the licensed business. The commenter noted that the applicant/licensee may have existing businesses unrelated to alcohol or gambling and sole proprietors often will have personal loans, unrelated to the proposed or existing licensed business, such as car loans, mortgages or student loans. Those loans may well have a guarantor who, the commenter argues, should not face a suitability investigation.

RESPONSE #8: Under the prior version of ARM 23.16.122(4)(b), vetting of guarantors is required as part of the application or loan approval process on applicant/licensee loans. The proposed amendments to ARM 23.16.122 do not change that requirement, but rather extend it to coborrowers and pledgors of assets as required by 23-16-118, MCA, as amended by SB 344.

The language in SB 344 did not address the use of loan proceeds or exempt loans unrelated to alcohol or gambling from the loan review process. In the department's view, regardless of what an institutional loan is used for, it is still an obligation of the licensed entity in which they could use profits from any of their business ventures (including the gambling operation) to pay the existing liabilities. If a guarantor is called on to make a payment on any of the licensee's loans (related to gambling/alcohol or not), that payment puts the guarantor in a position of sharing in the liabilities of the licensed entity necessitating a suitability investigation.

The new law eases restrictions on regulated loans, but requires the department to determine if the borrower, coborrower, guarantor, and pledgor meet the suitability requirements of 23-5-176, MCA. *See* 23-5-118(4), MCA. In the department's view, the statute must be applied to all licensees regardless of their entity type (i.e., corporation, LLC, sole proprietor, etc.). Therefore, the department will adopt the proposed rule as written over the commenter's objections.

COMMENT #9: One commenter objected to the requirement in ARM 23.16.122(5) and (7) to submit on Form 45 "all mandatory disclosures and related documentation" because new Form 45 has yet to be created and made available for review. The commenter seeks assurance that Form 45 will not impose requirements beyond information described in rule or statute.

RESPONSE #9: The department is developing Form 45 at this time. When completed, Form 45 will include the mandatory disclosures and documentation contemplated by statute and rule. The department recognizes the commenter's concern, but the form does not amount to governing law. Instead, it will serve the public by condensing the statutes' and rules' requirements in one form. Therefore, the department will adopt the proposed rule as written over the commenter's objection.

/s/ Matthew Cochenour
Matthew Cochenour
Rule Reviewer

/s/ Timothy C. Fox
Timothy C. Fox
Attorney General
Department of Justice

Certified to the Secretary of State October 2, 2017.